

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

77-5003

ORIGINAL

To be argued by
HARRY A. MARGOLIS

IN THE
United States Court of Appeals
For the Second Circuit

In re
THE FABRIC TREE, INC.,

Debtor.

MANGEL STORES CORPORATION,

Appellant,

against

THE FABRIC TREE, INC., Debtor and THE OFFICIAL
CREDITORS' COMMITTEE OF THE FABRIC TREE,
INC., Debtor,

Appellees.

On appeal from the United States District Court
for the Southern District of New York

**BRIEF OF THE OFFICIAL CREDITORS'
COMMITTEE OF THE FABRIC TREE, INC.,
DEBTOR, APPELLEE**

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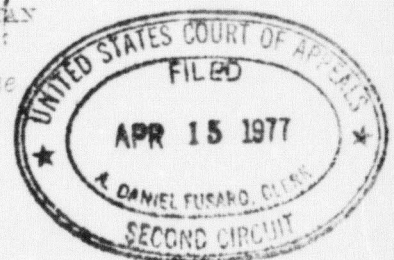


TABLE OF CONTENTS

	Page
Preliminary Statement.....	1
Statement of Issues.....	2
Statement of Facts.....	2
Findings Below.....	8
ARGUMENT.....	14
I. THE BANKRUPTCY COURT PROPERLY EXERCISED SUMMARY JURISDICTION IN DETERMINING MANGEL'S RIGHTS UNDER THE DEPOSIT AGREE- MENT BETWEEN MANGEL AND THE FABRIC TREE CREDITORS' COMMITTEE.....	14
A. To deny summary jurisdiction to determine Mangel's rights under the deposit agreement would emasculate the Bankruptcy Court's capacity to supervise this arrange- ment proceeding.....	14
B. Mangel consented to the summary jurisdiction of the Bankruptcy Court by surrendering property to an officer of the Court.....	22
II. MANGEL WAIVED ITS DUE PROCESS OBJECTION BY FAILING TO OBJECT AND BY PARTICIPATING IN THE HEARING ON THE MERITS.....	24
III. THE DISTRICT COURT PROPERLY DETERMINED THERE WAS A SUFFICIENT FACTUAL BASIS FOR THE BANKRUPTCY JUDGE'S ORDER OF AUGUST 2, 1976.....	26
A. Where there are concurrent findings of fact by the Bankruptcy Court and the District Court, the findings are accepted on appeal unless they are clearly erroneous.....	26

B. At the time the deposit agreement was signed, the July 15, 1976 date was not of the essence, so that a short delay in the confirmation process did not adversely affect Mangel's interest..... 27

C. By presenting objections which it knew were baseless, Mangel acted in bad faith and wrongfully prevented timely confirmation..... 35

Conclusion..... 38

TABLE OF CITATIONS

Cases:

Anderson v. Mt. Clemens Pottery Co., 328 U.S. 680 (1946).....	27
Bayview Estates, Inc. v. Bayview Estates Mobile Home-Owners Assoc., 508 F.2d 405 (6th Cir. 1974)	20, 21
In re Chatham Jewelers, Inc., 108 F. Supp. 385 (S.D.N.Y. 1952).....	27
Cox v. General Electric Co., 302 F.2d 389 (6th Cir. 1962).....	fn 5
In re Dunn, 422 F.2d 501 (2d Cir. 1970).....	26
Dyker Building Co. v. United States, 182 F.2d 85 (D.C. Cir. 1950).....	27
In re Fox Metal Industries, Inc. 453 F.2d 1128 (10th Cir. 1972).....	16, 17, 18
In re G.E.C. Securities, Inc., 331 F.2d 655 (2d Cir. 1964), <u>aff'g</u> , 223 F. Supp. 861 (S.D.N.Y. 1963).....	26
Governor Clinton Co., Inc. v. Knott, 120 F.2d 149 (2d Cir. 1941), <u>appeal dismissed</u> , 314 U.S. 701 (1942).....	16, 17, 18

	Page
Gulf Oil Corp. v. American Louisiana Pipe Line Company, 282 F.2d 401 (6th Cir. 1960).....	36, 37
Hayes Mfg. Corp. v. McCauley, 140 F.2d 187 (6th Cir. 1944).....	19, 29, 30, 31
In re H. L. Gentry Construction Co., 200 F. Supp. 546 (E.D. Mich. 1961), <u>aff'd</u> , 314 F.2d 945 (6th Cir. 1963).....	21
In re H. M. Kouri Corp., 66 F.2d 241 (2d Cir. 1933).....	23
In re Hollingsworth & Whitney Co., 242 F. 753 (1st Cir. 1917).....	23
In re Ira Haupt & Co., 379 F.2d 884 (2d Cir. 1967).....	26
In re Ira Haupt & Co., 424 F.2d 722 (2d Cir. 1970).....	22, 26
LeRoy Dyal Co., Inc. v. Allen, 161 F.2d 152 (4th Cir. 1947).....	32, 33, 34
Lillycrop v. Kinsky, 300 F.2d 736 (D.C. Cir. 1962).....	fn 5
New Jersey Co. v. Nathaniel Wise Co., 55 Misc. 294, 105 N.Y.S. 231 (1907), <u>aff'd</u> , 125 App. Div. 918, 109 N.Y.S. 1139 (1908).....	32, 33
Ohio Bell Telephone Co. v. Public Utilities Comm'n., 301 U.S. 292 (1937).....	24
In re Romero, 535 F.2d 618 (10th Cir. 1976).....	27
In re Riker, 107 Fed. 96 (S.D.N.Y. 1901).....	23
Simon v. Agar, 99 F.2d 853 (2d Cir. 1962).....	26
In re Sherman Plastering Corporation, 340 F.2d 915 (2d Cir. 1965).....	19, 20
In re Stockman Development Co., 447 F.2d 387 (9th Cir. 1971).....	15

	Page
Schwartz v. S. S. Nassau, 345 F.2d 465 (2d Cir. 1965), <u>cert. denied</u> , 382 U. S. 919 (1965).....	25
United States v. Chesapeake & Ohio Railway, 281 F.2d 698 (4th Cir. 1960).....	fn 5
United States v. Vitasafe Corp., 352 F.2d 62 (2d Cir. 1965).....	25
 <u>Statutes and Rules:</u>	
Bankruptcy Act, Section 44b, 11 <u>U.S.C.</u> §72b.....	22
Bankruptcy Act, Section 338, 11 <u>U.S.C.</u> §738.....	22
Bankruptcy Act, Section 339, 11 <u>U.S.C.</u> §739.....	22
Bankruptcy Rule 204(a), Rules of Bankruptcy Procedure.....	22
Bankruptcy Rule 810, Rules of Bankruptcy Procedure.....	26
Bankruptcy Rule 11-27, Rules of Bankruptcy Procedure.....	22
Bankruptcy Rule 11-29, Rules of Bankruptcy Procedure.....	22

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Docket No. 77-5003

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MANGEL STORES CORPORATION,
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-against-

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and THE OFFICIAL CREDITORS'
COMMITTEE OF THE FABRIC TREE,
INC., DEBTOR.

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE OFFICIAL CREDITORS' COMMITTEE OF
THE FABRIC TREE, INC., DEBTOR
APPELLEE

Preliminary Statement

This brief is submitted on behalf of Appellee, The Official Creditors' Committee of The Fabric Tree, Inc., Debtor, in opposition to the appeal of Appellant, Mangel Stores Corporation ("Mangel"), from the memorandum opinion and order of the Honorable Henry F. Werker, United States

District Judge for the Southern District of New York, dated January 11, 1977. Judge Werker's order affirmed the order of the Honorable Roy Babitt, Bankruptcy Judge, dated August 2, 1976, acting in the absence and upon the instructions of the Honorable Stanley T. Lesser, Bankruptcy Judge, confirming the arrangement of Appellee, The Fabric Tree, Inc., Debtor (the "Debtor"), under Chapter XI of the Bankruptcy Act.

Statement of Issues

1. Whether the Bankruptcy Court possessed summary jurisdiction to determine the rights of Mangel under a deposit agreement between Mangel and The Fabric Tree Creditors' Committee?

2. Whether Mangel waived its due process objection?

3. Whether the District Court properly determined there was a sufficient factual basis for the Bankruptcy Judge's order of August 2, 1976?

Statement of Facts

On August 5, 1975, the Debtor filed a petition for an arrangement pursuant to Chapter XI of the Bankruptcy Act in the United States District Court for the Southern District of New York. The Debtor was authorized, pursuant to Court order, to continue the operation of its business and to remain in possession of its property as a Debtor-in-Possession.

During the Chapter XI proceeding, the Debtor proposed to the Creditors' Committee several plans based upon funding to be obtained from various outside investors. The Creditors' Committee approved a plan under which general creditors were to receive 15% of their filed and allowed claims in cash and

installments (A. 213-214). * Before a plan of arrangement was filed, Mangel began discussions with Fabric Tree, its principals and the Committee toward the end that Mangel would fund a plan and acquire the Debtor. These negotiations resulted in the execution of three documents on May 4, 1976:

1. A "purchase and sale agreement" between Mangel and the principals of Fabric Tree under which Mangel agreed to purchase the stock of the principals and to employ them for at least one year (A. 216).

2. A "Loan and Security Agreement" ("Security Agreement") between Mangel and Fabric Tree under which Mangel agreed to issue its guaranty to the Debtor's inventory suppliers in exchange for a security interest in all of the Debtor's assets (A. 243). The Bankruptcy Court approved the Security Agreement on May 7, 1976.

3. An undated commitment letter ("deposit agreement") sent by Mangel to the Creditors' Committee under which Mangel agreed to deliver a \$600,000 certificate of deposit to the Committee Chairman, to be used to fund a 15% cash plan (A. 240). The deposit agreement provided that payment of the certificate to the disbursing agent was contingent upon the entry by the Bankruptcy Court of two orders: first, the Court had to approve the Security Agreement by May 10, 1976;

* References in parentheses are to pages of the Joint Appendix.

as indicated above, this requirement was satisfied; and second, the Court had to confirm a plan of arrangement on or before July 15, 1976, not exceeding \$450,000 for general unsecured claims and \$150,000 for administration and priority expenses.

The Debtor, relying upon the deposit agreement, filed a 15% cash plan (A. 214) which was subsequently accepted by creditors in accordance with the Bankruptcy Act.

From May to July, 1976, the Debtor used the proceeds from sales of inventory to pay operating expenses incurred in the ordinary course of business. Mangel knew the Debtor employed this procedure but permitted it to continue, even though the Security Agreement required the Debtor to make daily remittances of all receipts in their original form (A. 254).

At a hearing on July 13, 1976, the Bankruptcy Court fixed professional fees. Counsel for the Debtor advised the Court that the Debtor was prepared to proceed to confirmation.*

* In its brief, Mangel erroneously conveys the impression that the Creditors' Committee and Fabric Tree "were having difficulties performing" their part of the contract (Appellant's Brief at 6). In no way can the record be construed to support this view. The Committee properly obtained acceptances to the plan of arrangement and, on July 13, 1976, the Debtor's attorney stated to the Court, in Mangel's presence, that "the amounts fixed were well within the budgets for confirmation" (A. 278). Mangel also makes reference to two meetings in June at which the "parties" were present, implying that a representative from the Committee was present (Appellant's Brief at 6). Even Mangel's references to the record belie this assertion.

Although Mangel was present, it did not advise the Court of any objections it might have. The Court thereupon scheduled the hearing on confirmation (A.278-279).

Not until July 15, 1976 did Mangel first object to the use of the deposit for confirmation.* At that hearing Mangel contended that the terms of the deposit agreement had not been met since the \$150,000 ceiling on priority and administrative claims included normal operating expenses paid by the Debtor. The hearing on confirmation was adjourned to July 27, 1976 for a full presentation of the issue raised by Mangel. On July 27, 1976, Mangel raised another objection: It was no longer bound by its commitment and there could be no confirmation in any event, since the July 15, 1976 date had passed.

In order that administration expenses would not exceed the \$150,000 limitation under the deposit agreement, professionals involved in the arrangement proceeding agreed to

* In its brief, Mangel exhibits remarkable creativity in describing the events of July 15, 1976 (Appellant's Brief at 8-9). In the view of the Creditors' Committee, Judge Lesser was prepared to move towards confirmation on that day, and not to order the debtor's adjudication. Neither view, however, is of any consequence on this appeal, since no attempt was made by Mangel to comply with Rule 10(c) of the Federal Rules of Appellate Procedure, governing practice when a transcript is not available. Counsel's bare recital as to what transpired is not evidence, nor is it part of the record. Cox v. General Electric Co., 302 F.2d 389 (6th Cir. 1962); Lillycrop v. Kinsky, 300 F.2d 736 (D.C. Cir. 1962); United States v. Chesapeake & Ohio Railway, 281 F.2d 698 (4th Cir. 1960).

reduce their fees. The members of the Creditors' Committee also consented to reduce their claims by whatever amount was necessary, so that the 15% payments to general unsecured creditors would not exceed the \$450,000 ceiling.

On July 27, 1976, an evidentiary hearing was held. Mangel objected for the first time to the Court's exercise of summary jurisdiction and, after preserving this objection, participated at the trial, i.e., Mangel called witnesses and cross-examined those called by the Debtor. No due process objection was raised by Mangel on July 27, 1976. (Mangel first raised the due process objection after Judge Lesser rendered his decision on July 30, 1976.)

The evidence at the trial on July 27, 1976 disclosed that Mangel's security interest in the Debtor's assets gave it effective control over the business and fate of the Debtor, and the actual date of confirmation thereby had no substantial business significance (A.123-124, 125, 136, 198) *

The major asset Mangel sought in acquiring the Debtor was its leases at shopping center locations (A.185). Mangel

* On October 22, 1976, Judge Lesser entered an order giving Mangel possession of Fabric Tree's assets and authorizing foreclosure of its security interest (A.330-331).

intended to convert many of the Debtor's fabric stores to "Mangel-type" apparel stores,* but the decision as to which stores to convert was not to be made until six months after confirmation (A.111-113, 183-185). Mangel had already obtained control of these leases, which were not affected by the July 15, 1976 date, by acquiring the Debtor's stock, a security interest in the Debtor's assets and a stock pledge from the Debtor's subsidiaries (A.136-137, 187).

Mangel and the Debtor projected that Fabric Tree would not operate profitably before August 15, 1976 (A.120-121, 148-149, 156-157). Since the Debtor could only obtain goods on the basis of trade guarantees issued by Mangel, Mangel did not expect that confirmation would improve the Debtor's credit in the trade (A.125-126, 151-153). Prior to July 15, 1976, Mangel began cancelling orders and guarantees previously issued for the Debtor's benefit, thus making it impossible for the Debtor to conform to these projections (A.125-127, 159, 188-189).

* Mangel's capacity to slant the record cannot be understated. For example, Mangel points to the testimony of Mangel's president to support its view that "only four of Fabric Tree's 30 locations were being considered for future conversion" (Appellant's Brief at 32). An examination of the record discloses a different picture; Mangel selected four locations which it intended to convert "within a reasonable time and after that it would be as business continues." (A.184) (Emphasis supplied).

#

Mangel permitted the Debtor to pay its normal operating expenses, although the security agreement required that the Debtor remit its daily receipts to Mangel (A.90-93, 146-148).

Findings Below *

Judge Lesser found that the purposes of the July 15, 1976 date were: (1) "to fix a deadline in the mind of the creditors thereby galvanizing the creditors' committee into action to procure requisite acceptance at an early date"; and (2) to give Mangel an opportunity to protect itself if confirmation was not forthcoming (A.292-293).

Judge Lesser found that when the deposit agreement was made, "the season was critical, the specific date was not" (A.293). Mangel had already made the peak commitments for inventory for the fall season prior to July 15, 1976 (A.293). **

* Mangel urges that on July 30, 1976, the date of Judge Lesser's opinion, "the Court was not convinced that the debtor could meet the \$600,000 condition" (Appellant's Brief at 11-12). The passage to which Mangel refers cannot be construed to suggest that confirmation might not have been possible. If that were true, Judge Lesser's opinion would make no sense. Instead, Judge Lesser was concerned with the late hour on a Friday afternoon in the summer when no clerks were present to process the papers necessary to confirm (A.308).

** Although Mangel claims July 15 was the latest date orders could be placed to meet the fall season (Appellant's Brief at 16), the record discloses that by that date, inventory commitments for the fall season had already been made (A.128-129).

No landlord approval was to be obtained by July 15, 1976 regarding Mangel's desire to convert Fabric Tree stores into outlets for its ready-to-wear apparel (A.293).

Mangel sought out the Debtor and interposed itself into this proceeding as the funder of a plan of arrangement and purchaser of the stock of Fabric Tree (A.284). To that extent Mangel controlled the confirmation process. Although it never sat at the counsel table, its presence was constantly brought to the Court's attention (A.286).

As long as confirmation occurred within a reasonable time after July 15, 1976, Mangel would have received the full value of its bargain without prejudice; Mangel already had the power to control the business of Fabric Tree so that a few extra days of paper work was immaterial (A.293-294). Moreover, the certificate of deposit could not be dissipated since it did not mature until September 2, and interest to that date was payable to Mangel (A.295).

No later than the latter part of June or the early part of July, "Mangel had decided that it no longer favored the acquisition of Fabric Tree" and that "it...would use every available means to get out of the deal." (A.279, 297). Toward this end, Mangel began to cancel guarantees issued to suppliers on Fabric Tree's behalf, giving instructions that it would not be responsible for inventory purchases (A.297-298). Such conduct by Mangel was totally inconsistent with

its declared intention to acquire Fabric Tree as an operating entity (A.298).

Judge Lesser observed that Mangel should have apprised the Court and the Creditors' Committee of its intention to cut off the Debtor's supply of inventory because this "was a significant change in the ultimate value of the Debtor and the ultimate ability of the Debtor to exist if somehow the Mangel deal did not go through." (A.299).

By July 15, 1976, Mangel should have known that confirmation was not in jeopardy (A.294). Mangel was in Court on July 13, 1976, and was represented by counsel, when Judge Lesser fixed the fees to be allowed professionals (A.278). Mangel said nothing, even though counsel for the Debtor stated that the amounts fixed were well within the budgets for confirmation (A.278-279). Mangel failed to apprise the Creditors' Committee or the Court - though it had ample opportunity to do so - of its position that confirmation could not proceed on July 15 due to the excess of administration expenses (A.277-278). On July 13, 1976, Judge Lesser proceeded on the assumption that confirmation would take place on July 15, 1976 without any difficulty or delay (A.278-279, 280).

On July 15, 1976, Mangel contended that moneys used by the Debtor in its day-to-day operations to pay normal operating expenses should not have been used for that purpose (A.301). Judge Lesser found that Mangel waived its right

to require Fabric Tree to make daily remittances of its receipts by not insisting upon its rights under the Security Agreement (A.301), and that Mangel's argument that Fabric Tree lacked authority to pay normal operating expenses with daily receipts was "totally without merit" (A.302), and was "raised primarily for the point of thwarting confirmation." (A.300). He based this conclusion on the testimony of Joseph Lamm, president of Mangel, who admitted that the only item he understood would be included in the \$150,000 ceiling was past due expenses in the Chapter XI proceeding at the time Mangel began to finance the Debtor (A.303).

"Mr. Crammes: Was it ever your thinking Mr. Lamm, that the \$150,000 was intended to include items other than pre-Chapter XI priority claims, court costs and fees?"

"A.: That was my understanding."

"Mr. Crammes: That it would include just those items or others as well."

"A.: Just those items."

"A.: It was to include pre-Chapter XI claims, allowances and any administration claims up to the time that we came into the picture." (A.149).

According to Judge Lesser, Mangel's position went far beyond the practice in bankruptcy under which the only funds the Debtor is required to deposit upon confirmation are those necessary to pay unpaid priority and administration expenses existing at that time (A.303-304).

Judge Lesser concluded that Mangel's objections on July 15, 1976 with respect to the \$150,000 limit on

administration expenses were not raised in good faith (A.300). In fact, confirmation did not occur on July 15, 1976 because of the strong position taken by Mangel and its "statements about personal liability," which resulted in counsel for the Debtor not pressing for confirmation at that time (A.304). Finally, Judge Lesser determined that Mangel could not take advantage of a delay for which it was responsible (A.305).

Based upon the foregoing findings of fact, Judge Lesser made the following conclusions of law:

1. "...[T]ime was not strictly of the essence in the performance of the condition that an order of confirmation be entered on or before July 15, 1976." (A.292).
2. "...Mangel's conduct hindered the performance of the condition so as to permit at this juncture a reasonable delay in its accomplishment on the part of Fabric Tree." (A.296)
3. "...Mangel's bad faith, and to a certain extent lack of candor otherwise estops it upon [sic] relying on the absence of a confirmation order on July 15, 1976." (A.296).
4. "...[T]he failure to comply with the condition about confirmation on or before July 15, 1976 does not preclude the creditors' committee from turning over the certificate of deposit to the disbursing agent..." (A.306).

Since Judge Lesser expected to be away from his office, he authorized Judge Babitt to sign the order of confirmation. This was done on August 2, 1976. Mangel appealed to the District Court and, in a memorandum opinion and order dated January 11, 1977, Judge Werker affirmed the decision of the Bankruptcy Court, concurring with its findings of fact and conclusions of law.

ARGUMENT

POINT I

THE BANKRUPTCY COURT PROPERLY EXERCISED
SUMMARY JURISDICTION IN DETERMINING
MANGEL'S RIGHTS UNDER THE DEPOSIT AGREE-
MENT BETWEEN MANGEL AND THE FABRIC TREE
CREDITORS' COMMITTEE

A. To deny summary jurisdiction to determine Mangel's rights under the deposit agreement would emasculate the Bankruptcy Court's capacity to supervise this arrangement proceeding.

The Security Agreement dated May 4, 1976, between Mangel and the Debtor, which received the Court's approval, contained the following provision:

"Mangel intends to provide funds to Fabric [Tree] to confirm a plan of arrangement in the Proceedings and in connection therewith has contracted to purchase all of the outstanding common stock of Fabric [Tree]." (A.243).

On the same day, and in accordance with the above provision, Mangel entered into the deposit agreement with the Creditors' Committee, pursuant to which Mangel agreed to deliver a \$600,000 certificate of deposit, to be used to confirm the Debtor's arrangement with its creditors. Mangel also agreed to purchase the stock of the principals of Fabric Tree and to employ them for at least one year.

These three agreements comprised the entire package by which Mangel would obtain control of Fabric Tree and its assets.

The Bankruptcy Court concluded that since it had authorized the Security Agreement, it possessed summary jurisdiction to resolve issues raised under the deposit agreement. Judge Lesser determined that the subject at issue was "integral and vital" to the Court's authority "to supervise the confirmation" in the arrangement proceeding, and that a contrary ruling would "emasculate" its capacity to oversee the proceeding (A.283).

The District Court agreed:

"By the time that the controversy over the escrow terms arose, Mangel had also become intimately involved in the operations of Fabric Tree: Fabric Tree had moved its corporate offices to the headquarters of Mangel and for some time Mangel had permitted Fabric Tree to use revenues derived from retail sales to pay expenses. This was done despite a clause in the security agreement which required Fabric Tree to first turn its revenues over to Mangel. Mangel was also present at bankruptcy court sessions held to consider the ultimate disposition of Fabric Tree. Although the record below does not show when Mangel formally entered an appearance, Judge Lesser noted that Mangel's 'presence was here. We felt it. We saw it. We were told about it.'

"I therefore conclude that it would work an unfair imposition upon the operations of the bankruptcy court were it not permitted to decide disagreements under the escrow agreement. In doing so, I am mindful that chapter XI arrangements serve ameliorative purposes distinct from those of other bankruptcy proceedings and that they therefore justify a broad construction of the court's jurisdiction. See In re Stockman Development Co., 447 F.2d 387 (9th Cir. 1971)." (A.333).

Summary jurisdiction has been held proper, and not limited by the concept of actual or constructive possession of property, where a contrary ruling would amount to an imposition upon or interference with the operations of the Bankruptcy Court, as in the case of fraud, Governor Clinton Co., Inc. v. Knott, 120 F.2d 149 (2d Cir. 1941), appeal dismissed, 314 U. S. 701 (1942), or a refusal to honor an agreement with a court-appointed officer. In re Fox Metal Industries, Inc., 453 F.2d 1128 (10th Cir. 1972).

In Governor Clinton, a case relied upon by Judge Werker, the Bankruptcy Court ordered the repayment of moneys which were not within the custody of the Court. This exercise of summary jurisdiction was upheld by the Court of Appeals for the Second Circuit which stated that:

"...[S]ummary jurisdiction may be invoked for purposes other than to protect property within the actual or constructive possession of the court. Here a contract was made with the debtor in possession and a fraud worked on the estate through a common conspiracy among the respondents. This amounts to a fraud and imposition upon the court itself; and in such cases, the court undoubtedly has summary jurisdiction to protect itself and the interests of the persons and property within its custody." 120 F.2d at 152.

In Fox Metal, also relied upon by the District Court, Frontier, a subcontractor, entered into an agreement with a sub-subcontractor's court-appointed Receiver, to modify Frontier's payment schedule under the sub-contract. The agreement with the Receiver was not approved by court order.

Performance began to lag and Frontier stopped payment of checks which were returned unpaid for insufficient funds. The Bankruptcy Court found it unnecessary to determine whether the unpaid checks constituted property within the actual or constructive possession of the Court. The Bankruptcy Judge then exercised summary jurisdiction:

"...I'm looking through the checks as to what actually the relationship of the parties was. And the thing that impresses me is -- I just am convinced that there was an imposition on the receiver and on the property of the court as far as these people were concerned. They sought to become whole at the expense of the receivership and to let them get away with it, as I say, would give them property to which they are not equitably entitled." 453 F.2d at 1130.

As stated by the Court of Appeals:

"The trial court indicates...that summary jurisdiction of the Bankruptcy Court should be asserted because Frontier, which made an agreement with the Receiver in May 1970, breached that agreement when it refused to render to Receiver the value of the two checks. The trial court's holding is that this agreement with the court-appointed Receiver and its performance, is a part of the operation of the receivership under the court's supervision. It is thus a participation by Frontier with the Receiver, in the function of the receivership itself, and not with Fox. Such participation would, under this theory, place Frontier within the court's jurisdiction over the receivership." 453 F.2d at 1130.

Though fraud was not alleged in Fox Metal, the Court of Appeals relied upon Governor Knott in which fraud was held to be an imposition on the Court, and concluded that Frontier's

refusal to honor an agreement with the Receiver likewise worked an imposition on the Court and provided a basis for summary jurisdiction.

"We must hold that the trial court properly exercised its summary jurisdiction in the issue concerning the unpaid checks, by reason of [Frontier's] participation in the receivership as above indicated, and its imposition on it or interference therewith." 453 F.2d at 1131.

The District Court observed that Fox Metal and Governor Clinton "present unusually compelling reasons to proceed by summary jurisdiction." (A.332). The Court agreed with the Bankruptcy Judge that the case at bar merits similar treatment.

"The security agreement submitted to and approved by the bankruptcy court granted Mangel an interest in assets plainly within the custody of the court. But that agreement comprised only one element of a larger plan whereby Mangel would gain control of Fabric Tree and its assets. The extent to which the signing of each agreement hinged upon the successful negotiation of the others is best demonstrated by reference to the language of the security agreement presented to the court below for approval." (A.332-333).

Moreover, the District Court implied that the additional factor present here, namely, the Court-approved Security Agreement, provides even greater reason to apply the principles of Governor Clinton and Fox Metal.

"Neither the Fox Metal nor the Governor Clinton court relied upon the presence of a res in custodia legis to find that summary jurisdiction existed. Moreover, unlike the instant action, the two cases did not involve contractual arrangements which had been submitted to the bankruptcy court for its formal approval." (A.333-334).

The Court-approved Security Agreement and the deposit agreement were both part of the same overall transaction whereby Mangel would acquire the Debtor; both were so inter-related as to constitute a single transaction. See Hayes Mfg. Corp. v. McCauley, 140 F.2d 187 (6th Cir. 1944) (Contracts considered by court to be interrelated because of cross-references in each of them to the others). Were it otherwise, the funding provision in the Security Agreement would be superfluous. The Creditors' Committee's consent to the order authorizing the Security Agreement was predicated upon the deposit agreement which was to fund the plan. One agreement would not have been entered into by any of the parties without the others; they were related parts of one transaction.

In the case of In re Sherman Plastering Corporation, 340 F.2d 915 (2d Cir. 1965), involving a subcontractor's arrangement proceeding, the general contractor, the subcontractor and the assignee of the subcontractor's accounts receivable entered into an agreement whereby the contractor agreed to finish a project and make payment to the assignee. This agreement was entered into at the Referee's suggestion in his chambers, but without entry of a formal order of approval. A dispute later developed regarding a claim by the assignee against the contractor. The Court of Appeals for the Second Circuit held that the Bankruptcy Court had summary jurisdiction to determine the dispute:

"...[A] multi-party compromise often gives rise to a variety of interrelated claims some of which do not directly involve the debtor. We think it a reasonable construction of the [Bankruptcy] Act to say that, where a party enters into an agreement before the Referee, it thereby subjects itself to the bankruptcy court's summary jurisdiction as to the entire dispute over enforcement of the agreement."

The factual pattern in the instant appeal compels applicati of the same principle. Unlike Sherman where no order was entered, here there was an order approving and authorizing the Security Agreement. That agreement was only part of the plan by which Mangel was to acquire the Debtor by purchasing its stock and by funding an arrangement with its creditors.

That the Bankruptcy Court had jurisdiction with respect to the Security Agreement is not disputed. The deposit agreement, being an integral part of the acquisition of the Debtor by Mangel, was likewise subject to the Court's jurisdiction.

Mangel participated in the confirmation process and was intimately involved in the Debtor's operations. Denial of summary jurisdiction to determine Mangel's rights under the deposit agreement "would work an unfair imposition upon the operations of the bankruptcy court" (A.333) and would emasculate its capacity to supervise this arrangement proceeding (A.283).

Mangel relies upon Bayview Estates, Inc. v. Bayview Estates Mobile Home-Owners Assoc., 508 F.2d 405 (6th Cir.

1974), and In re H. L. Gentry Construction Co., 200 F. Supp. 546 (E.D. Mich. 1961), aff'd, 314 F.2d 945 (6th Cir. 1963), which cases held that the bankruptcy court lacked summary jurisdiction over escrow funds established by parties other than the debtor. Judge Werker concluded, however, that in "neither of these cases was the creation of the escrow fund even remotely related to matters then pending before the bankruptcy court." Unlike Bayview Estates and Gentry Construction,

"...the escrow fund in the instant action... (1) was an important part of the overall plan to gain court approval of a satisfactory arrangement, (2) grew out of negotiations involving both Fabric Tree and the Committee and (3) was conditioned upon the entry by the bankruptcy court of an order approving the plan of arrangement." (A.335).*

The record abundantly demonstrates that Mangel's participation in the confirmation process and its refusal to honor agreements with the Debtor and the Creditors' Committee would, if summary jurisdiction were denied, work an unfair

* On the jurisdictional question, all of the other authorities relied upon by Mangel (Appellant's Brief at 22-25) are inapposite. In fact, they were all cited to the District Court which did not even find it necessary to treat them in its opinion.

imposition upon the capacity of the Bankruptcy Court to supervise this arrangement proceeding. As stated by the District Court:

"...[D]enial of summary jurisdiction here would, in my opinion, seriously impose upon efforts undertaken by the Bankruptcy Court at the behest of many parties including Mangel." (A.335).

The Bankruptcy Court's findings of fact in support of its exercise of summary jurisdiction are not clearly erroneous, but rather are supported by the weight of the evidence. In re Ira Haupt & Co., 424 F.2d 722 (2d Cir. 1970); see cases cited in Point III. A., infra. The Bankruptcy Court therefore properly exercised summary jurisdiction in determining Mangel's rights under the deposit agreement.

B. Mangel consented to the summary jurisdiction of the Bankruptcy Court.

Alternatively, the Bankruptcy Court ruled that Mangel's deposit of a \$600,000 certificate of deposit with the Creditors' Committee, in its official capacity, placed that fund under the Court's control, bringing its ultimate disposition within the jurisdiction of the Court (A.283-284). An Official Creditors' Committee is an officer of the Court, having been designated by Court order. See §§44b, 338 and 339 of the Bankruptcy Act and Rules 204(a), 11-27 and 11-29 of the Rules of Bankruptcy Procedure.

It is well settled that the Bankruptcy Court has

summary jurisdiction to determine conflicting claims to property which is in custodia legis. In re Riker, 107 Fed 96 (S.D.N.Y. 1901). Voluntary surrender of property in controversy to the Bankruptcy Court or its officer is equivalent to a consent to jurisdiction, and the Court may then exercise jurisdiction over all claims in respect to such property. In re H. M. Kouri Corp., 66 F.2d 241 (2d Cir. 1933)

In the case at bar, the delivery by Mangel of the certificate of deposit to an officer of the Court was equivalent to a consent to the summary jurisdiction of the Bankruptcy Court. An agreement made with an officer of the Bankruptcy Court, appointed by it in a pending case, is regarded as an agreement with the Court, and disputes arising under such an agreement may be resolved by the Bankruptcy Court's exercise of summary jurisdiction. In re Hollingsworth & Whitney Co., 242 F. 753 (1st Cir. 1917). In addition, Mangel appeared at the hearing on confirmation on July 15, 1976 and made no objection to confirmation on jurisdictional grounds. Mangel thus consented to the exercise of summary jurisdiction by failing to object.

POINT II

MANGEL WAIVED ITS DUE PROCESS
OBJECTION BY FAILING TO OBJECT
AND BY PARTICIPATING IN THE
HEARING ON THE MERITS

Before the evidentiary hearing on July 27, 1976, Mangel objected to the court's jurisdiction, but made no objection on "due process" grounds. Mangel raised its jurisdictional objection again before any witnesses were called, but then agreed to participate in the hearing on the merits, during which it called several witnesses and cross-examined witnesses called by the Debtor (A.71-89, 98-103 108-109, 127-135, 137-145, 165-172, 174-178, 208-210).

Mangel did not make any "due process" objection until after Judge Lesser delivered his opinion.

The District Court concluded that Mangel was not a party with no advance notice of the nature of the proceeding. Ohio Bell Telephone Co. v. Public Utilities Comm'n., 301 U.S. 292, 307 (1937). The District Court also concurred with an observation made in the Court below:

"... Mangel was not a stranger to the proceeding: it knew of the prior confirmation hearings before the bankruptcy court and was not

taken by surprise. Moreover, having just come out of Chapter XI itself, it must have also been familiar with the operations of the bankruptcy court.

"I therefore conclude that Mangel knowingly waived its due process objection to the hearing below by failing to object. See, e.g. United States v. Vitasafe Corp., 352 F.2d 62 (2d Cir. 1965); Schwartz v. S.S. Nassau, 345 F.2d 465,466 (2d Cir.), cert. denied, 382 U.S. 919 (1965)." (A.335-336).

Mangel's counsel, being well versed in bankruptcy practice and procedure, carefully preserved the objection to the exercise of summary jurisdiction. Counsel could have made and preserved a due process objection at the same time. In its brief, Mangel concedes that it did not make such an objection (Appellant's Brief at 29). Having failed to make a "due process" objection, Mangel cannot complain on appeal. Moreover, Judge Lesser fairly conducted the trial held on July 27, 1976, without, in any way, violating the constitutional rights of any of the parties.

POINT III

THE DISTRICT COURT PROPERLY
DETERMINED THERE WAS A SUFFI-
CIENT FACTUAL BASIS FOR THE
BANKRUPTCY JUDGE'S ORDER OF
AUGUST 2, 1976

A. Where there are concurrent findings of fact by the Bankruptcy Court and the District Court, the findings are accepted on appeal unless they are clearly erroneous.

The Bankruptcy Court made detailed findings of fact with which the District Court concurred. Where there are concurrent findings of fact by the Bankruptcy Court and the District Court, the findings are accepted on appeal unless they are clearly erroneous. In re Ira Haupt & Co., 424 F.2d 722 (2d Cir. 1970); In re Ira Haupt & Co., 379 F.2d 884 (2d Cir. 1967). See also In re Dunn, 422 F.2d 501 (2d Cir. 1970); In re G.E.C. Securities, Inc., 331 F.2d 655 (2d Cir. 1964), aff'g., 223 F. Supp. 861, 863 (S.D.N.Y. 1963); Simon v. Agar, 299 F.2d 853 (2d Cir. 1962).

Rule 810 of the Rules of Bankruptcy Procedure provides in relevant part:

"*** The Court shall accept the referee's findings of fact unless they are clearly erroneous, and shall give due regard to the opportunity of the referee to judge the credibility of the witnesses."

The Bankruptcy Court's findings of fact are supported by substantial evidence and are not clearly erroneous. See Anderson v. Mt. Clemens Pottery Co., 328 U.S. 680, 689 (1946); Dyker Building Co. v. United States, 182 F.2d 85 (D.C. Cir. 1950). Judge Lesser had the opportunity to observe the demeanor of the witnesses and to weigh their credibility. In re Romero, 535 F.2d 618 (10th Cir. 1976).

The District Court's function was limited to "determining whether or not the referee's findings were clearly erroneous." In re Chatham Jewelers, Inc., 108 F. Supp. 385, 386 (S.D.N.Y. 1952) (Court's emphasis). The District Court properly determined there was a sufficient factual basis for the Bankruptcy Judge's order of August 2, 1976.

B. At the time the deposit agreement was signed, the July 15, 1976 date was not of the essence, so that a short delay in the confirmation process did not adversely affect Mangel's interest.

The Bankruptcy Judge concluded that at the time the deposit agreement was signed, the July 15, 1976 date was not of the essence, and a short delay in the confirmation process did not adversely affect Mangel's interest.

The District Court concurred with this finding:

"It is a fair inference from the evidence that time was not of the essence when the escrow agreement was signed. Mangel intervened in the chapter XI negotiations primarily because it wanted to convert lucrative shopping center sites leased by Fabric Tree into outlets for

Mangel's apparel. Yet, the purchase and sale agreement did not require the Fabric Tree principals to request that landlords consent to such modifications until well after the July 15, 1976 'deadline'. During the interim, it was Mangel's initial intention to continue operating fabric stores at the shopping centers.* Mangel also had to make most of its inventory commitments for the fall season in advance of the July 15, 1976 date, whether or not confirmation resulted. Thus, a few days of delay would not have changed the scope of the Mangel financial commitment to Fabric Tree.

"Operationally, there was also no difference between the proposed and the actual date of confirmation. Fabric Tree was already housed in Mangel headquarters. Moreover, the escrow fund was in the form of a certificate of deposit payable on September 2, 1976. Therefore, payments to creditors and others would not have taken place until that date even if the plan had been approved at an earlier time; and interest on the certificate continued to accrue to Mangel regardless of the confirmation date.

"... I agree with [the Bankruptcy Judge's] finding that at the time the contract was signed it was the season, not the date, of confirmation that was of significance to the parties and that confirmation on August 2, 1976 was therefore timely." (Citations omitted) (A.336-337).

* To refute the District Court's conclusion that time was not of the essence, Mangel even distorts its opinion and implies it was poorly reasoned. Mangel states that "Judge Werker himself acknowledged that it was 'Mangels' [sic] initial intention to continue operating fabric stores at the shopping centers" (Appellant's Brief at 32). Judge Werker "acknowledged" much more, however - Mangel intended to continue operating fabric stores "[d]uring the interim," that is, until it could convert these stores into outlets for its own apparel (A.336). Not satisfied with distorting the facts, Mangel finds it necessary to misrepresent Judge Werker's opinion

Whether time is of the essence in a contract is an issue of fact, to be determined by the trier of fact, subject only to the "clearly erroneous" test. Hayes Mfg. Corp. v McCauley, 140 F.2d 187, supra.

The facts in Hayes are strikingly similar to the case at bar. McCauley, an inventor, held patent rights to a steel airplane propeller. He had organized a corporation to fabricate products called for by his invention. Hayes was a successful corporation with stock listed and traded on the New York Stock Exchange. Negotiations between the parties resulted in three written agreements. By the first, McCauley was to turn over to Hayes all of his stock in the propeller company in exchange for 25,000 shares of the Hayes stock and \$5,000 in cash. The agreement provided that Hayes would take such steps as might be required by the laws of Michigan or of the United States to properly register and qualify its shares. It further provided that the purchase and sale would be consummated as soon as possible, but in no event later than 90 days after the date of the agreement.

Pursuant to two collateral agreements, McCauley gave Hayes an exclusive license under his inventions and McCauley was granted a three year employment contract. In this connection the Court stated:

"That the contracts are inter-related is made evident by the cross-references in each of them to the others." 140 F.2d at 189.

In the instant case, the deposit agreement, the security agreement and the stock purchase and employment agreement between Mangel, the principals of the Debtor and the Creditors Committee, are all interrelated as is indicated by the cross-reference in each of them to the others.

Upon execution of the agreements, Hayes took over management of the propeller company, ordered machinery at a cost of \$30,000 and made advances to the propeller company of \$10,000 for the payment of current obligations. It also took steps to issue and list its own stock but was unable to do so within the 90 day period because the propeller company was in such bad financial shape that it was unacceptable to the Securities and Exchange Commission and the Stock Exchange. McCauley thereupon asserted that he had the right to cancel the agreement. However, the Court determined that the issues raised questions of fact to be determined after trial, reasoning as follows:

"Even though time is of the essence of the contract equity may relieve where the application of the general rule would work an unconscionable forfeiture.

* * *

"...[W]hile no precise form of words is required to make time the essence of the contract, yet its intrinsic nature, the circumstances of its execution, the conduct of the parties, the fact of substantial partial performance, and the inequity of a refusal to grant specific performance when it results in forfeiture repugnant to equity, are all circumstances to be taken into consideration in determining whether or not time is of the essence," 140 F.2d at 190.

As a court of equity, the Bankruptcy Court correctly viewed all of the circumstances surrounding the execution of the agreements, the intention and conduct of the parties and determined that time was not of the essence and that "...the acts and conduct of [Mangel] were responsible for the delay." 140 F.2d at 190.

The Court in Hayes was very concerned that strict adherence to the time limitation would work an unconscionable forfeiture. It is obvious in the instant case that such a forfeiture will result from a reversal of the order of confirmation. Mangel was granted a security interest in and to all of the Debtor's assets and has been permitted by the Bankruptcy Court to foreclose its security interest. Mangel now asks this Court to permit it to retain all of the Debtor's assets without paying the \$600,000 to creditors which was part of the consideration for the acquisition.

That the enforceability of such a provision in a contract is to be determined in light of all of the surrounding circumstances is further evidenced by the case of LeRoy Dyal Co., Inc. v. Allen, 161 F.2d 152 (4th Cir. 1947), wherein the defendant attempted to rescind a contract to purchase potatoes on the ground that they had been delivered a day or two early. The court held the defendant to the contract finding that the defendant had, prior to the delivery date, determined to get out of the contract in any way he could, because of a declining market for potatoes. Judge Lesser made similar findings in the instant case.

The Court in the LeRoy case reasoned as follows:

"***[I]t will be noted that the growing tendency has been to modify the harsh and often inequitable rule of the common law, and the courts now determine each case upon its own peculiar facts, the question as to whether time is of the essence of the contract being one of construction controlled by the intention of the parties, and the courts, in the absence of an express stipulation making time as of the essence, are not disposed to so treat it, unless the surrounding circumstances make it apparent that the parties intended that it should be ineffectual unless performed within the time stated.

"In New Jersey Co. vs. Nathaniel Wise Co., 55 Misc. 294, 105 N.Y.S. 231, 233, it was said:

'The rule that time is to be regarded as of the essence was originally designed to carry out the presumed intention of the parties. When it is clear that the application of this rule would be contrary to the intention of the parties, the reason for the application of the rule no longer exists, and the rule itself is inoperative. The adoption of a reasonable construction, which gives effect to the original intention of the parties, is more in harmony with the spirit and reason of the general rule than is adherence to a narrow and literal interpretation, which does not effectuate such intention.'

"***[T]he materiality of the failure should be determined by ascertaining whether it would be more just to free the injured person or to require him to perform his promise ... The circumstances of the pending case clearly bring it within the ambit of this just and equitable view. ... The buyer indeed was not influenced by the fear that either circumstance would cause him loss; his sole concern was to find some legal basis to free him from his contract obligation. ... [T]he rule is that in such situation the surrounding circumstances furnish the guide to the court

in determining whether the failure to perform it at a fixed time relieves the other contracting party from his contract obligation." 161 F.2d at 155.*

Judge Lesser properly looked to the surrounding circumstances and found that Mangel was not adversely affected by the slight delay and should not be permitted to reap the fruits of its bargain and at the same time, receive a return of its \$600,000. It is respectfully submitted that Judge Lesser's opinion and the order of confirmation should be affirmed in all respects.

* In its brief, Mangel makes no serious attempt to show that time was of the essence in its acquisition of the Debtor, but relies on strict compliance with the July 15, 1976 date. The most recent case relied upon by Mangel for strict construction of such a provision was decided in 1923 (Appellant's Brief at 34-35). It is respectfully submitted that the cases cited herein demonstrate that "...the growing tendency has been to modify the harsh and often inequitable rule of the common law..." which Mangel would have this Court impose. As stated by Judge Werker:

"Mangel's recitation of many older cases holding to the contrary is of little value as each case should be decided after an examination of the particular evidentiary facts surrounding it, and not upon generalizations." (A.337).

C. By presenting objections which it knew were baseless, Mangel acted in bad faith and wrongfully prevented timely confirmation.

The Bankruptcy Court found as a fact that in the latter part of June or the beginning of July, "Mangel decided that it no longer favored the acquisition of Fabric Tree," and "would get out of the ... transaction in any way possible." (A.279,297). Mangel then began to cancel purchase orders and trade guarantees entered into on Fabric Tree's behalf, instructing suppliers that it would not be responsible for inventory purchases (A.297-298). Judge Lesser concluded that these actions were calculated to thwart confirmation. The Bankruptcy Court further concluded that "Mangel's bad faith, and to a certain extent lack of candor otherwise estops it upon [sic] relying on the absence of a confirmation order on July 15, 1976." (A.296).

The District Court concurred with this view:

"I also share the bankruptcy court's view that Mangel wrongfully prevented confirmation on July 15, 1976. At that time, Mangel argued that Fabric Tree's use of loan funds to pay expenses incurred prior to May 7, 1976, as well as current operating costs raised the total amount necessary to pay administration and priority expenses above the agreed upon amount of \$150,000. However, prior to July 15, 1976, Mangel had not insisted that Fabric Tree remit its daily receipts to Mangel. Thus, it had waived the right to rely upon

the security agreement clause requiring immediate delivery of such items to Mangel. The president of Mangel also testified that he did not expect current operating costs to be charged against the \$150,000 allocation. In light of this testimony Mangel cannot seriously contend that such costs should be included. More importantly, the testimony shows that Mangel presented the court with objections it knew were baseless.

....

"...[T]he bankruptcy judge found that Mangel's objections on July 15, 1976 were not raised in good faith. Much of the record lends support to this finding particularly the cancellation by Mangel of orders and guarantees previously issued for the benefit of Fabric Tree. Judge Lesser also concluded that Mangel's objections and threats of suit had caused counsel for Fabric Tree to abstain from requesting confirmation on July 15, 1976. Mangel has not shown this finding to be clearly erroneous. I, therefore, agree with the Court below that Mangel, having thwarted timely confirmation, may not now rely upon the passage of the escrow agreement deadline to justify cancellation of the contract and return of the escrow fund." (A.337-338)

The case of Gulf Oil Corp. v. American Louisiana Pipe Line Company, 282 F.2d 401 (6th Cir. 1960), relied upon by the District Court, manifestly supports this conclusion. There, American had agreed to purchase gas from Gulf provided approval could be obtained from the Federal Power Commission within six months. During the application process, Gulf included conditions not part of the agreement with American which it knew or should have

known would delay final approval of the application beyond the six months required by the contract. The Court of Appeals held that Gulf was obligated to do nothing which would hinder, delay or prevent approval of its application within the time provided by the contract, and that it could not rely on the delay which it brought about by its own conduct to justify its cancellation of the contract.

"Where liability under a contract depends upon a condition precedent one cannot avoid his liability by making the performance of the condition precedent impossible, or by preventing it." 282 F.2d at 404.

In the instant appeal, Mangel was obligated not to interfere with the confirmation process. Yet, the record discloses a completely different course of conduct. Once Mangel resolved not to acquire Fabric Tree, it cancelled orders and guarantees, thereby jeopardizing the Debtor's supply of inventory and its ability to operate. On July 15, 1976, at the hearing on confirmation, Mangel raised objections which it knew were baseless, and which made it impossible to complete confirmation on that day. Mangel acted in bad faith and wrongfully prevented timely confirmation; it may not rely on the delay which it caused to justify return of the certificate of deposit.

Conclusion

The Bankruptcy Court properly exercised summary jurisdiction in determining Mangel's rights under the deposit agreement between Mangel and The Fabric Tree Creditors' Committee. It is respectfully urged that denial of summary jurisdiction in this case would emasculate the Bankruptcy Court's capacity to oversee the arrangement proceeding and work an unfair imposition upon its operations. Reversal of the order of confirmation would leave nothing for creditors, including taxing authorities and wage claimants.

The District Court properly determined there was sufficient factual basis for the Bankruptcy Judge's order of August 2, 1976 and accordingly, its order of January 11, 1977 should be affirmed in all respects.

Respectfully submitted,

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Service of 2 copies of the
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Attorney for [Signature]

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